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Internal audit and oversight

Internal audit and oversight*

Report of the Administrator

Summary

The present report provides information on the activities relating to internal audit and investigation services provided by the Office of Audit and Performance Review (OAPR) for the year ended 31 December 2005. As requested by the Executive Board in its decision 2005/19, the report contains: (a) selection criteria of the country offices audited; (b) presentation of audit recommendations by frequency of occurrence and by priority, and a further analysis regarding the underlying causes of audit issues; (c) report on the status of the most frequent and highest priority recommendations, according to the framework approved in decision 2004/39; (d) results of the review of internal audit resources; (e) development of risk management; (f) strengthening of analysis of outcomes of audits of non-governmental organizations (NGO)/nationally-executed (NEX) projects; and (g) training provided to field-based staff to follow up on NGO/NEX audit findings and recommendations. The report also contains management responses and actions taken to date on significant issues raised in internal audit reports.

Elements of a decision

The Executive Board may wish to: (a) take note of the present report; (b) express support for the continued strengthening of the UNDP internal audit and investigation services, and its request for additional resources; and (c) recognize the initiatives of OAPR in promoting a risk-management culture in UNDP.

*The compilation of data required to provide the Executive Board with the most current information has delayed submission of the present report.

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Contents

I. Introduction 3

II. The oversight function of OAPR 3

III. Significant events in 2005 6

IV. Country office audits 7

A. Basis for selection of countries to be audited 7

B. Results of country office audits 8

V. Headquarters audits 14

VI. Evaluation of audits of non-governmental organizations or nationally executed projects 15

VII. Investigation services 21

VIII. Advisory and management services 23

IX. Coordination with external auditors 23

X. Coordination with other United Nations oversight offices 23

XI. Framework for the future 23

Annexes (*available on the UNDP Executive Board website*)

1. OAPR country office risk-assessment model
2. Six-month action plan for strengthening oversight in UNDP, focusing on internal audit and investigation
3. Significant issues in internal audit reports and management responses and actions
4. UNDP involvement in the oil-for-food programme inquiry
5. Country office audits conducted in 2005
6. Audit terms and definitions
7. Significant issues in NGO/NEX audit reports
8. Investigation statistics

I. Introduction

1. The Administrator is pleased to provide the Executive Board with the annual report for the year ended 31 December 2005 of OAPR on internal audit and investigation services rendered to UNDP and its affiliated agencies, funds and programmes, with the exception of the United Nations Office for Project Services (UNOPS) which is presented in a separate report.[1]

2. The year 2005 has been a period for team-building and strengthening capacity in OAPR after a reprofiling exercise. With the appointment of the Director in November 2004, it was time to raise the profile and strengthen the role of OAPR in pursuit of a stronger regime of oversight, transparency, and accountability in UNDP.

3. This annual report presents the steps taken to help management strengthen the governance of oversight; improve planning and execution of audit and investigation work; enhance coordination with management, the external auditor, and other oversight bodies; and reinforce the investigation arm of the office. It also sets out the results achieved in audits of selected functional areas at headquarters; audits of country offices, including directly executed (DEX) projects; the rendering of management and advisory services; the review of audit reports on NGO and/or NEX projects; and the conduct of investigations.

4. This report and its annexes include information required by the Board in its decision 2005/19, such as (a) the risk-assessment model used to select country offices to be audited; (b) prioritization of audit recommendations based on risks; (c) analysis of issues arising from country office audits based on frequency of occurrence and priority; and (d) further analysis of the underlying causes of these audit issues. In addition, the report on the status of the most frequent and highest priority recommendations between 2003 and 2005 and actions taken to date has been updated based on the framework approved in decision 2004/39. Finally, it sets out the results of the review of internal audit resources, the development of risk-assessment functions, and training provided to field-based staff to interpret and follow up on NGO/NEX audit findings and recommendations, as well as management responses and actions taken on the audit recommendations made between 2003 and 2005.

II. The oversight function of OAPR

5. The organizational arrangements for the corporate internal oversight functions in UNDP relate to audit, investigations, and evaluation. Evaluation is effected by the Evaluation Office, while internal audit and investigation functions are discharged by OAPR. In addition, the Management Review and Oversight Committee (MROC) provides advice to management in matters relating to the results of audit and investigation activities. The oversight group of the Executive

[1] UNOPS: report on internal audit and oversight (DP/2006/32)

Team serves as a forum for coordinating the work of OAPR, the Evaluation Office, and the Operations Support Group. On investigation matters, OAPR closely coordinates with the Office of Legal and Procurement Support (OLPS).

6. The external oversight of UNDP and its affiliated organizations is performed by the United Nations Board of Auditors (BOA), which is elected by the General Assembly, to which it reports through the Advisory Committee on Administrative and Budgetary Questions and the Fifth Committee. In its decision last year, the Executive Board requested that arrangements be made for BOA to present its report at the annual session 2006.

7. The internal audit arm of OAPR provides independent, objective assurance of the adequacy of existing internal controls; the regularity of all transactions and activities and their compliance with regulations, rules, policies and procedures; and the appropriate, efficient and effective use of available resources in achieving the purposes for which they are allocated to UNDP offices. These services are provided through audits of country office operations (including regional service centres), DEX projects, and offices, departments, and bureaux at headquarters, Copenhagen, and Bonn. OAPR provides advisory services to all these offices, as appropriate; monitors annual audits of NGO/NEX projects; and assesses the 'NGO/NEX audit reports'. The investigation arm of OAPR conducts fact-finding investigations into allegations of fraud, theft, or misuse of UNDP resources and/or authority, and submits its conclusions to OLPS. To achieve those objectives in a more efficient, effective manner, OAPR introduced new initiatives and improvements in the audit and investigation services. These are:

Governance of oversight

8. An important element in achieving OAPR objectives is the institution of strong, independent governance of oversight mechanisms. In UNDP, the primary mandate of MROC is to advise on financial management and reporting, internal control arrangements, and matters relating to external and internal audits. The committee was renamed the 'Audit Advisory Committee', reconstituted so that no members are UNDP staff members, and its terms of reference revised to adopt best practices. The members were selected based on their professional background, work experience, interest in the work of UNDP, and willingness to provide their services pro bono.

Risk-based audit planning

9. In the past five years, the selection of country offices to be audited, as well as that of offices, bureaux and units at headquarters, was based on an ad hoc risk-assessment approach, resulting in a very long audit cycle for all countries regardless of their risk ranking.[2] In 2005, OAPR developed a risk-assessment model for country offices, which was used to identify offices to be audited in 2006 (see annex 1 for the country office risk-assessment model). A new model is being developed for headquarters, for introduction in 2006. The purpose of using this approach is to ensure that audit resources are applied in areas of operations

[2] In the past five years (2000-2004), 65 per cent of 135 country offices were audited once and 14 per cent were never audited since 2000. This means that a country was audited on an average of four to five years. And for offices at the headquarters, OAPR was able to perform an average of less than four audits a year, most of which were of limited scope.

considered high risk, namely, those that could hamper the successful achievement of UNDP objectives.

Review of OAPR resources

10. As requested by the Board in 2004, and in response to various studies and reviews, OAPR assessed its resources during 2005. The review indicated the need to (a) strengthen the leadership in the regional audit service centres (RASCs) covering the Arab States and Europe and the Commonwealth of Independent States, and (b) enhance the capacities in RASCs and in the headquarters internal audit section responsible for headquarters audits; the investigation section; and the review of NGO/NEX annual audits (see annex 2 for the six-month action plan).[3] After an assessment of the proposal, the posts of Chief of RASC Lebanon and Bratislava as well as an administrative assistant in Dakar sub-centre were approved, and recruitment is under way.

The cost of audit for 2005 is as follows:

Staff	4,111,934
Operating expenses	2,026,091
Cost of NEX audits by national auditors[4]	3,302,470
Total	$9,440,495

Trend analysis of results of audits and investigations as management tools

11. OAPR continued to analyse audit results and outcomes of the audits of NGO/NEX projects covered in the 2004 audit cycle, and identified systemic and corporate issues considered high-risk and needing immediate action and/or decision by management. The outcome of the analysis was presented in meetings of MROC and the executive team, workshops for new resident representatives and deputy and assistant resident representatives, and some regional bureau workshops. The results are set out in chapters IV to VII.

Increased audit coverage and improved reporting

12. The activities and outputs of OAPR in 2005 increased significantly compared to 2004. During the year, 41 country offices audits were conducted and 37 reports were issued (17 and 20, respectively, for audits conducted in 2004 and 2005). The remaining reports are to be issued by June 2006. At headquarters, three audits were conducted in what were considered mission-critical aspects of UNDP operations, such as the implementation of the Atlas system and the IT security system. Recommendations made and actions taken by management to address the issues raised are summarized in paragraphs 37-40 and 45-47 and are detailed in annex 3.

[3] A proposal entitled *Six-month action plan for strengthening oversight in UNDP focusing on internal audit and investigation* was prepared by OAPR.

[4] Directly charged against project budgets

13. OAPR streamlined the format of audit and investigation reports to alert management to key issues and significant recommendations needing their immediate attention and action.

Enterprise risk management

14. As requested by the Executive Board, OAPR introduced enterprise risk management in UNDP. While OAPR notes that management and staff perform risk assessments and mitigate and manage these risks, these have not been adopted as explicit business practices and may not be done in accordance with best practices. OAPR is therefore championing the mainstreaming of risk management in the organization.

15. Towards the end of 2005, OAPR initiated the introduction of enterprise risk management at the Global Management Team meeting held in January 2006. The experience of other United Nations organizations such as the Office of the United Nations High Commissioner for Refugees (UNHCR) and the World Food Programme (WFP) and, for the benefit of harmonization, the pro-bono services of PricewaterhouseCoopers were used for this exercise. OAPR, the Bureau of Management (BOM), regional bureaus, and staff from PricewaterhouseCoopers conducted a thorough review of documentation; interviewed senior officers at headquarters and resident representatives; held two workshops, at which they drew an initial risk map of UNDP; and conducted a survey on the current risk culture in UNDP. The results of these workshops were presented at the global meeting. The road map for implementing enterprise risk management in UNDP is being drawn under the leadership of the new Associate Administrator.

III. Significant events in 2005

16. Two significant events in 2005 – the tsunami in South Asia and the investigation of the oil-for-food programme (OFP) by the Independent Inquiry Committee (IIC) – also greatly affected the activities of OAPR.

Tsunami-related activities

17. Immediately after the relief and response operation was put into place in the tsunami-affected countries, and in consideration of the significant financial contributions to these operations, OAPR deployed a risk-assessment mission to UNDP Indonesia to help the country office identify risk areas and control weaknesses in their systems at the early stage of operations. The mission identified 11 risk areas, and the highest one is in the procurement area resulting from collusion among suppliers. BOM and the country office in Indonesia obtained pro bono technical support from the international audit firm Deloitte & Touche in strengthening its procurement processes and training programme staff in Aceh.

Investigation by the Independent Inquiry Committee into the United Nations oil-for-food programme

18. In 2004, the Secretary-General created the IIC and mandated it to review and investigate allegations concerning the management and operations of the OFP. This investigation covered many facets of the OFP, including the activities and operations of all participating United Nations organizations, including UNDP as the implementing agency for the electrification programme in Northern Iraq. With

the leadership of the Regional Bureau for Arab States (RBAS), UNDP organized a group to provide the material requested by the IIC investigators. OAPR searched for records, responded to written and verbal questions; reviewed and organized documents brought from Amman, Baghdad, and Abu Dhabi; and participated in meetings and consultations. These activities, which lasted for almost eight months until the report was issued in September 2005, were accorded the highest priority and transparency.

19. After the investigation, OAPR reviewed the IIC-OFP reports and identified specific issues, which it brought to the attention of UNDP management. These issues contributed to the proposed OAPR six-month action plan. The significant issues raised are set out in annex 4 and are linked to the IIC report, available on the IIC website. The main issue raised by the IIC was that the rate set for the reimbursement of administrative fees was high and all United Nations organizations, including UNDP, reimbursed OFP in a total amount of $5.8 million.

IV. Country office audits

This chapter deals with the results of audits undertaken in country offices during 2005 and the responses and actions taken by the management of those offices.

A. Basis for selection of countries to be audited

20. In December 2004, OAPR carried out country office risk assessments as the basis for planning audits for 2005. This process took into account the date and outcome of the last audit, volume and level of operations or deliveries, number of office staff, previous investigations conducted, and complexity of the country office business. The bureaux were consulted on the final list of countries that were then audited in 2005 (see section B).

21. In 2005, OAPR improved this process and developed a country office risk-assessment model (see annex 1), which was used for selecting countries to be audited in 2006. The model considers quantitative and qualitative risk factors, specifies risk scores, and facilitates risk ranking. It involves participation of regional bureaux in the risk-measurement exercise, and results are consolidated at the corporate level to obtain the rankings of all countries. The quantitative risk factors are: (a) total programme delivery by country office; (b) total programme resources allocation; (c) total office budget allocation; (d) number of authorized personnel; (e) number of projects; (f) number of purchase orders; (g) number of months of strategic reserve; (h) time elapsed since last OAPR audit; and (i) time elapsed since last external audit. The qualitative factors are: (a) special development situation of country office; (b) significant changes in policies, systems and procedures; (c) last OAPR audit rating; (d) results of recent OAPR investigations; (e) turnover at country office senior management level; (f) results of NGO/NEX project audit evaluations and outsourced DEX audits; and (g) concerns of other stakeholders.

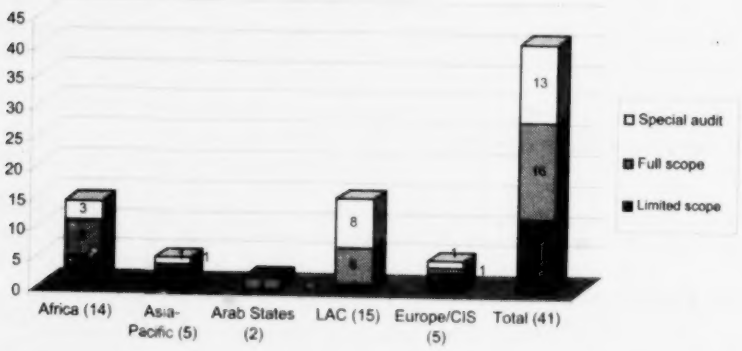
22. Using a risk-based planning system enables OAPR to optimize its limited resources by focusing on the areas most important to UNDP. The system thus gives reasonable assurance to UNDP management that significant and critical auditable areas are adequately covered, and that recommendations resulting from these audits would add value to country offices and UNDP as a whole.

B. Results of country office audits

Audits conducted

23. In 2005, a total of 41 audits were conducted in 36 countries. In terms of audit coverage, 16 of the 41 audits were full scope, 12 limited scope, and 13 were special audits (see annex 5 for list of country offices audited and annex 6 for type of audit).

Figure 1. Country office audits conducted in 2005



Audit reports issued during the year

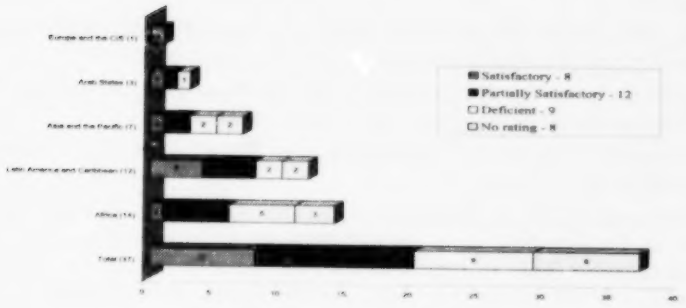
24. The timely issuance of audit reports has been one of the areas that OAPR needed to improve, and it will continue to do so. Significant investments were made to streamline the reports and issue them on a timelier basis. During the year, a total of 37 audit reports were issued, of which 17 were for 2004 and 20 for 2005. The remaining 21 for 2005 are to be issued by June 2006. The results from these 37 audit reports are the basis for reporting and responding to the Board request for an analysis of audit ratings, frequency of issues, prioritization of audit recommendations, and causes of audit remarks, as set out in the succeeding paragraphs.

Audit ratings

25. Of the 37 reports issued, eight (22 per cent) received a satisfactory rating; 12 (32 per cent) partially satisfactory; nine (24 per cent) deficient; and eight (22 per cent) no specific rating[5] (see annex 6 for definitions of audit ratings). In addition to the overall rating in the outcome of an audit, OAPR indicates specific ratings for each of the auditable areas, (namely, the country programme level; management strategies; knowledge sharing and implementation of practices; partnerships and resource mobilization; support to United Nations coordination; advocacy services; development service; human resources administration; procurement, inventory and office premises; financial resources; general administration; and information technology and communications). This process provides guidance to country offices as to areas requiring attention.

[5] Those without specific ratings usually refer to special audits that are focused on specific business areas only.

Figure 2. Audit reports issued in 2005, by rating



Audits of DEX projects and ratings

26. In auditing country office activities, OAPR also audits DEX projects and incorporates the results in the country office audit reports. However, where project expenditures are significant or other risk factors exist, OAPR carries out special audits of selected DEX projects, using internal audit resources or local audit firms.

27. Two such audits were carried out in 2005, in Somalia and Afgnanistan. The review of 32 DEX projects in Somalia had a satisfactory rating (covering 1 January 2001 to 31 December 2003) and an unqualified opinion on the statement of expenditures. The review of the voter registration projects in Afghanistan had a deficient rating (covering 1 August 2003 to 30 September 2004) and a qualified opinion on the statement of expenditures. This rating was primarily the result of an understatement of financial expenditure due to the non-recording of commitments; weaknesses in the management and recording of non-expendable equipment and assets; and shortcomings in the procurement process. As at 31 December 2005, 75 per cent of the recommendations had been implemented by the office, and a follow-up audit is being organized for Afghanistan in 2006.

Frequency and prioritization of audit recommendations

28. To identify frequency of occurrence and priority of action required from the offices concerned, OAPR analyzed the 37 reports containing 1,144 recommendations. The most frequent recommendations (see figure 3) pertained to financial resources (16 per cent), development services (14 per cent), human resources administration (14 per cent), and general administration (14 per cent), which together represent 58 per cent of the total recommendations (see annex 6 for definitions of recommendation categories).

29. Most recommendations on financial resources pertained to banking operations and cash management, commitments, disbursements and receipts and on development services pertained to project design, appraisal and approval, and project monitoring, such as:

(a) Timely completion of monthly bank reconciliation and immediate clearing of reconciling items;

(b) Discontinuation of salary advances to local staff that are not adequately justified or are not in compliance with the personnel and financial manual;

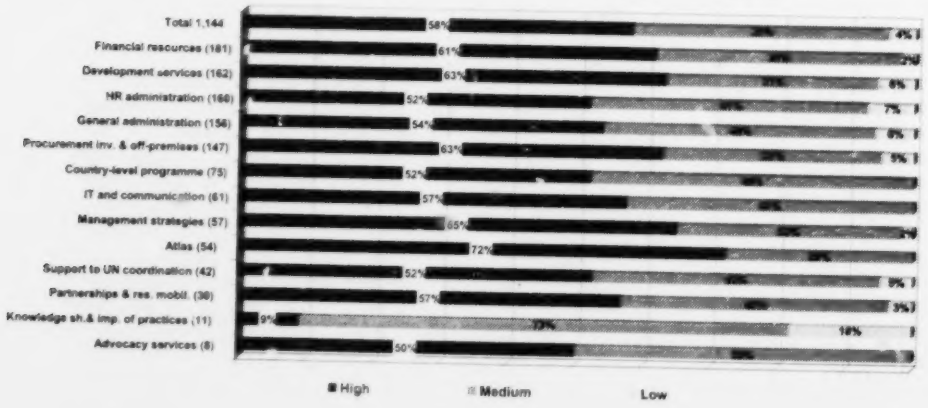
(c) Regular conduct of physical inventory of country office assets and maintenance of inventory records;

(d) Improvement in the design stage of project documents and review of those documents by the project appraisal committee;

(e) Competitive selection of consultants and full documentation of the recruitment process.

30. Further analysis of each audit area shows that although only 45 (or 4 per cent) of the 1,144 recommendations pertained to Atlas implementation, 80 per cent of such recommendations were of high priority. This was expected, as the audits covered mostly the first year of Atlas implementation. Other high-priority recommendations pertained to management strategies; procurement; development services; and financial resources.

Figure 3. Frequency and prioritization of country office audit recommendations in 2005 reports



Causes of audit findings and observations

31. The analysis of the causes of audit issues pertaining to the 1,144 recommendations indicated that the most common cause (48 per cent) was non-compliance with UNDP regulations, rules, policies and procedures. The two other significant causes were the absence or inadequacy of written procedures or instructions (primarily in country offices) to guide staff in the performance of their duties (21 per cent) and inadequate or no supervision (19 per cent). Other reasons were lack or inadequacy of resources – such as funds, skills, staff or time – to carry out an activity or function (8 per cent) and human error or mistakes committed by staff (3 per cent). It should be noted that these causes are not mutually exclusive, as there can be instances when two or more reasons behind an issue are interlinked.

Table 1. Audit recommendations by category and cause in 2005 audit reports – percentages

Area	Compliance	Guidelines	Human error	Resources	Guidance	Total
Country-level Programme	56	22	5	5	12	100
Management	48	16	7	10	18	100
Knowledge-sharing and implementation of practices	38	38	0	0	25	100
Partnerships and resource mobilization	74	0	0	9	17	100
Support to United Nations coordination	43	21	7	10	19	100
Advocacy services	63	13	0	0	25	100
Development services	52	22	2	11	13	100
HR administration	61	13	3	11	13	100
Procurement	36	25	7	10	22	100
Finance	45	15	2	8	30	100
General administration	60	10	3	6	21	100
IT and communication	41	22	3	12	23	100
Atlas	7	84	2	0	7	100
Total	**48**	**21**	**3**	**8**	**19**	100

32. While non-compliance was an issue in 2004 and 2005 (see figure 4), it decreased over the period from 62 to 48 per cent. We observed improvements in the Arab States (from 96 to 57 per cent) and Asia and the Pacific (from 83 to 57 per cent). The situation remained generally the same for Latin America and the Caribbean (from 48 to 50 per cent) and for Europe and the CIS regions (from 63 to 68 per cent). In the Africa region, the rate increased from 26 to 39 per cent.

Figure 4. Comparison of causes: 2004 and 2005 audit reports

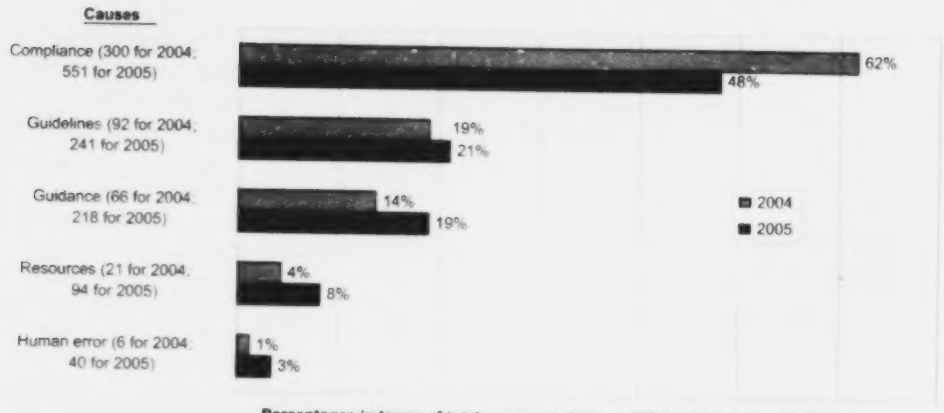


Table 2. Comparison of causes by region (2004-2005) – percentages

Causes	2004						2005					
	RBA	RBAP	RBAS	RBEC	RBLAC	Total	RBA	RBAP	RBAS	RBEC	RBLAC	Total
Compliance	26	83	96	63	48	62	39	57	57	68	50	48
Guidelines	44	14	2	12	17	19	19	29	17	0	20	21
Guidance	25	0	0	17	25	14	28	4	14	11	20	19
Resources	5	3	2	8	6	4	13	8	11	16	2	8
Human error	0%	0	0	0	4	1	1	2	1	5	8	4
Total	100	100	100	100	100	100	100	100	100	100	100	100

RBA = Regional Bureau for Africa; RBAP = Regional Bureau for Asia and the Pacific; RBAS = Regional Bureau for Arab States; RBEC = Regional Bureau for Europe and the CIS; RBLAC = Regional Bureau for Latin America and the Caribbean.

Corporate issues

33. In conducting country office audits, OAPR identified corporate issues that were systemic or key issues that required decision or action by a concerned office or bureau at headquarters, and might call for the review of existing policies or the formulation of new ones. These were brought to the attention of senior management through the transmittal letters that accompanied the audit reports.

34. One of the corporate issues pertained to the implementation of a 'no objection' clause in the loan agreement with a major donor. In having this clause, some country offices did not submit proposals to the contracts, assets and procurement committee and to the advisory committee on procurement for awarding contracts, as they understood that this requirement had been dispensed with. The concerned units at headquarters are now reviewing the issue.

35. Another issue is that of procurement audits conducted by local external auditors as required by other donors. This is considered contrary to the single-

audit principle and exposes UNDP to unnecessary reviews by third parties. The concerned units at the headquarters are working with OAPR in addressing this.

Good practices

36. OAPR identified some good practices during their country office audits, which were conveyed to management to share with other offices. In Colombia, the country office prepared a national human development report (NHDR) that was well received by civil society and government agencies. In the Dominican Republic, the national human development report project implemented an NHDR curriculum and a degree programme with one of the local universities.

Management responses and actions on country office audit recommendations

37. OAPR relies on the offices to provide regular updates on the implementation of recommendations through the UNDP comprehensive audit and recommendations database system. Every six months, OAPR reviews the overall status of implementation, makes an assessment, and provides a rating that is reflected in the 'balanced scorecard'. The implementation status is validated at a subsequent audit of the country office, an immediate special follow-up audit or a desk review.

38. For audit reports issued in 2005, the management of the country offices concerned responded well to the audit findings, providing explanations and clarifications, agreeing with the recommendations, and indicating a time frame and the staff and office responsible for implementation, which are presented in annex 3.

39. As of 31 December 2005, the overall implementation rate by country offices was 81 percent. The implementation rates ranged from 18 to 98 per cent, with most offices having an implementation rate above 75 percent. This indicates that the offices are committed to implementing audit recommendations.

40. UNDP has proactively implemented several corporate initiatives equipping managers to manage risks better in the country where they operate and providing them with the required environment, information, tools, and policy guidelines to address financial and operational risks in the country offices. Key initiatives included: (a) initiation of the management accountability framework and enterprise risk management initiative; (b) enhancing key reporting tools, such as the 'executive snapshot', which enables managers in headquarters and country offices to view and track their budgets, project expenditures and approved spending limits, helping them to oversee their operations and discharge their fiduciary responsibilities more effectively, as well as the Atlas data quality 'dashboards' which allows the staff to track status and rectify key issues such as bank reconciliation, manual checks, asset data discrepancies, and errors in payment vouchers or purchase orders; (c) implementing the staff professionalization programme, which requires UNDP project managers and procurement and financial staff to be certified for their functional roles in the organization; (d) leveraging the close partnership with internal and external auditors to analyse the root causes of recurring audit issues through the quality assurance function established in BOM; (e) promoting transparency in the management of audit issues and related risks by tracking corporate issues using the UNDP 'audit tracking dashboard'; (f) providing country and project offices with direct access to a single, authoritative source of prescriptive content and policies in UNDP in three

languages (English, Spanish and French) and eliminating the multitude of outdated manuals and ad hoc circulars.

V. Headquarters audits

41. Audit activities undertaken at headquarters in 2005 consisted of a review that covered the overall project management for introducing the first phase of the Atlas system ('wave 1'), a review of controls and risks identified in the post-implementation environment, and an information security risk assessment.

42. The Atlas wave 1 post-implementation review identified and assessed the key remaining challenges to achieving system stability, and provided recommendations to improve the next wave of implementation by drawing on lessons learned from the experience of implementing wave 1. The review covered governance; planning and project management; project budget and expenditures; testing of the system designed and implemented; training Atlas users in its support systems; and relevant business processes. OAPR made 48 recommendations, with the high-priority ones dealing with strengthening the governance mechanisms and management structure at the strategy and direction level to better support the 'wave 2' process; training and transferring knowledge of the challenges that come with the Atlas environment; and testing wave 2.

43. The post-implementation review of Atlas in UNDP, UNFPA and UNOPS covered Atlas implementation in the areas of finance, human resources, and payroll, and identified significant risks in the key areas of control framework definition, business process controls, and application security controls. The review resulted in 80 agency-wide recommendations, including high-priority ones on a global security management system; assessment of existing reports and queries; the entire disbursement processes; and factors that contributed to bank reconciliation problems.

44. Lastly, OAPR conducted an exhaustive review of the risks associated with information security in UNDP headquarters in New York. The review focused on 12 areas: information security policies; organizational and information security infrastructure; information communication technology risk assessment; asset classification and control; personnel security, physical and environmental security; communications; operations management and business continuity; access control; systems development and maintenance; project management and quality control; services-level agreements; and monitoring and evaluation. The review resulted in 54 recommendations, including high-priority areas on the comprehensive physical security program for information systems and equipment, administration of application access control, and review of log monitoring and analysis.

Management responses and actions on headquarters audit recommendations

45. As of 31 December 2005, the implementation rate for headquarters audits was 48 per cent. Considering the complexity of most of the recommendations and the report dates, this rate is a definite indication of progress. Significant issues identified in reports, strategies for addressing them, the time frame for implementation, and indicators of progress or completion are presented in annex 3. The high-priority recommendations that were implemented included: (a) strengthening the ICT governance mechanism with stronger participation of

regional bureaux and country offices in the ICT board, as well as regular reporting and review of the project progress, using PRINCE2 project methodology; (b) implementing the enhanced Atlas training strategy and staff professional certification programme to improve staff competency; (c) strengthening in-house technical capacity to maintain and support wave 2; (d) disseminating the internal control framework guidelines, together with implementation of an enhanced Atlas security management system to track approval of user requests as well as to enforce principles of segregation of duties in processing user access requests; (e) simplifying Atlas reports, including bank-to-book reports, and the financial and asset data quality dashboard.

46. Those recommendations in progress have been divided into three categories: (a) Atlas enhancements currently in progress; (b) necessary changes that require further discussion and harmonization with our United Nations partner organizations and/or with United Nations accounting standards; and (c) ongoing process improvements. Several of the Atlas wave 2 enhancements are expected to be completed in 2006 or early 2007.

47. The recommendations relating to IT security are being reviewed by the recently appointed chief technology officer for the implementation of high-priority items and funding requirements. Remediation plans are being established to address key risks in the interim.

VI. Evaluation of audits of non-governmental organizations or nationally executed projects

48. Annual audits of NGO/NEX projects, known as 'NGO/NEX audits', are conducted (where annual expenditures amount to $100,000 or more) either by supreme audit institutions or by private audit firms contracted by the project management (or by UNDP at the request of the government). Competitive selection of the local auditors and how the audits are conducted are based on OAPR guidelines. At the conclusion of these audits, OAPR at headquarters reviews and evaluates all the reports to assess the outcome, scope, and process of the audit exercise.

NGO/NEX audit process

49. In 2005, OAPR continued to reinforce the review and monitoring of annual NGO/NEX audits by standardizing the terms of reference for the audits and providing country offices with guidance in assessing and selecting auditing firms. OAPR strengthened the evaluation process by devising a strategy with more in-depth analysis of the outcome of the audits covering the fiscal year 2004.

50. OAPR reviewed the reports from 114 country offices and conveyed the outcome of its assessment through evaluation letters sent to the resident representatives and copied to the regional bureaux, the Operations Support Group, BOM and the United Nations Board of Auditors.

NGO/NEX Audit Reports

51. The challenge with NGO/NEX audits for fiscal year 2004 was the introduction of Atlas, which made it difficult for project management and country offices to produce the combined delivery reports (CDRs) by the required submission date. Of 1,822 projects initially planned to be audited in 2005, OAPR received reports

on 1,717 projects from 114 country offices. For the 105 reports not submitted on time (6 per cent), follow-up is ongoing to ensure that all reports are completed and submitted for OAPR review. The number of reports received and the levels of expenditure for the last two financial years are shown in figure 5.

Figure 5. NGO/NEX audit reports by region received in 2004 and 2005

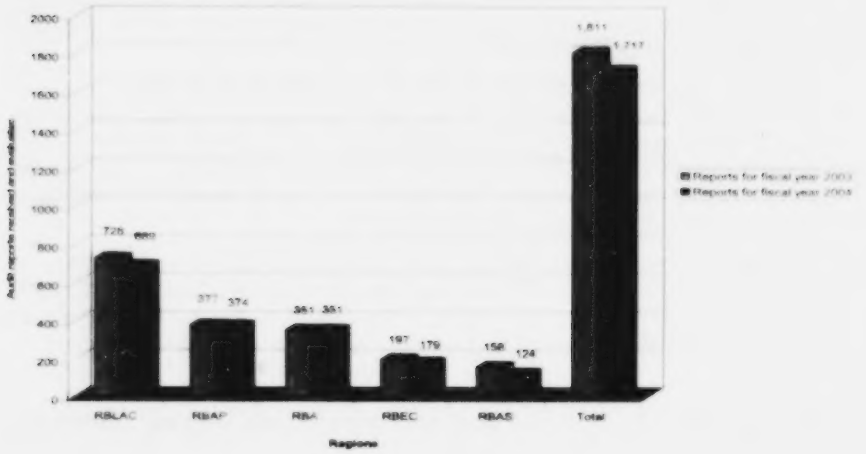


Table 3. NGO/NEX estimated expenditures by region and number of country offices for fiscal years 2003 and 2004

NGO/NEX	RBA	RBAP	RBAS	RBEC	RBLAC	Total
2003 estimated expenditures	$143 million	$217 million	$54 million	$69 million	$938 million	$1.4 billion
2003 countries	44	22	11	22	23	122
2004 estimated expenditures	$151 million	$241 million	$69 million	$91 million	$959 million	$1.6 billion
2004 countries	38	22	11	21	22	114

New strategy for evaluation of NGO/NEX audit reports

52. In the context of using risk management as a methodology for strengthening the quality control of oversight over NGO/NEX projects, OAPR introduced a new evaluation strategy in 2005, expanding the scope, review, and analysis of audit reports, which will contribute towards the envisaged risk-based model. The new evaluation strategy covered three aspects of NGO/NEX project audits (each aspect being rated as either satisfactory, partially satisfactory, or deficient – see annex 6 for definitions):

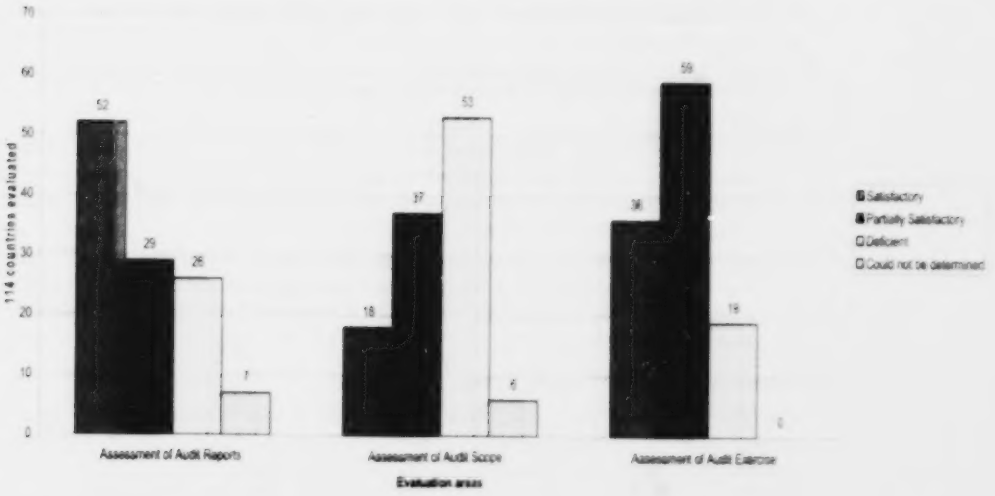
(a) *Review of the audit outcome*, which involves the review of audit findings based on an assessment of the risks involved, their severity, and their possible impact on the overall implementation of NGO/NEX projects. The project management is accountable for this segment of the audit exercise.

(b) *Review of the audit scope*, which involves an assessment of the adequacy of audit coverage in NGO/NEX audit reports based on the minimum requirements set out in the terms for reference for the NGO/NEX auditors. The local external auditor is accountable for this.

(c) *Review of the administration of the audit exercise*, which involves the overall assessment of how the NGO/NEX audit exercise was performed for the current year. The country office management is accountable for this.

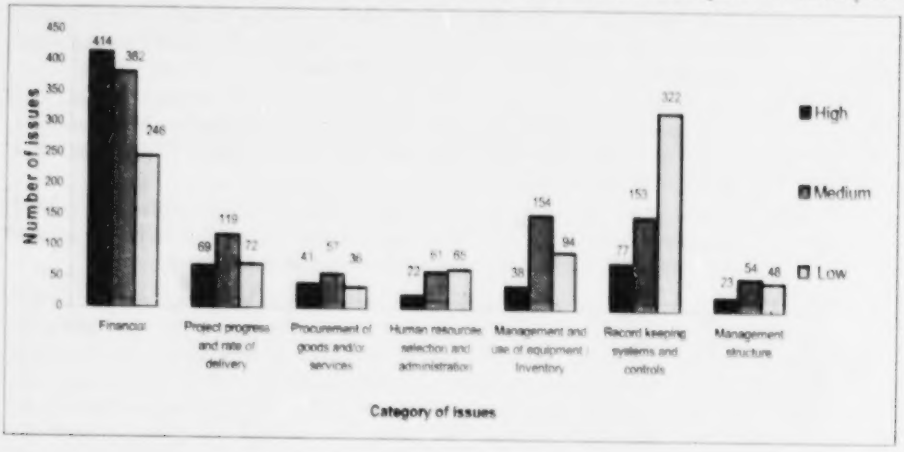
53. The review, analysis, and quality control is a work in progress, and the model should be continuously reviewed for further improvement as a tool for obtaining assurance of the efficient, effective use of resources in NGO/NEX projects. The results of this exercise, at this point, are more indicative than conclusive. The initial results of this new evaluation strategy are reflected in figure 6, where out of 114 countries that were covered, the rating of 'satisfactory' was awarded to 52 offices for the audit outcome, to 18 offices for the adequacy of audit scope, and to 36 offices for the administration of the audit exercise.

Figure 6. Outcome of the aspects of the new assessment strategy – 2005



54. The NGO/NEX audits covered seven audit areas (see annex 6 (a) for definitions), which were assessed based on the severity of the risks likely to occur if the audit issues are not addressed and rated as either high, medium or low. In addition, OAPR analysed and identified the possible causes of the issues so as to assist country offices and project managements in prioritizing their efforts when implementing a control framework that would address the issues raised in a timely and effective manner.

Figure 7. Distribution and categorization of audit issues in NGO/NEX audit reports for fiscal year 2004



55. Figure 7 shows that the highest risks for NGO/NEX projects are in financial management; record-keeping systems and controls; and the management and use of equipment.

(a) *Financial management (1,042 issues, or 41 per cent).* Discrepancies between the CDRs submitted and the Atlas-generated CDRs (amounting to $13.9 million, or 0.87 per cent of the total estimated NEX expenditures); bank reconciliations not carried out regularly; inadequate segregation of duties; lack of control over petty cash.

(b) *Record-keeping systems and controls (552 issues, or 22 per cent).* Lack of supporting documentation for payments; quarterly financial reports not submitted on time; payment vouchers not approved; incomplete personnel files; incomplete or inaccurate accounting records.

(c) *Management and use of equipment (286 issues, or 11 per cent).* Physical inventory incomplete or lacking; equipment not tagged; equipment used for purpose other than for the project; no vehicle log maintained; inadequate safeguarding of project equipment.

Causes of the NGO/NEX audit issues

56. The causes of the 2,547 NGO/NEX audit issues identified were: lack of compliance; guidelines; guidance; human error; and lack of resources. The causes are presented in table 4 (see Annex 6 (d) for definitions).

57. Table 4, opposite, shows that the main causes of the audit issues, across all regions, were lack of compliance and lack of guidance. OAPR highlighted the possible causes of the audit issues in the NGO/NEX evaluation letters issued to the resident representatives, and requested that project and country office management immediately address these causes by submitting management comments to OAPR in the form of an action plan indicating the corrective actions and implementation of audit recommendations (see annex 7). In addition, through the RASCs and workshop conferences, OAPR is undertaking a campaign in increasing awareness of these issues.

Table 4. Causes of the audit issues in fiscal 2004: percentages, by region

Possible cause	RBA	RBAP	RBAS	RBEC	RBLAC	Total
Compliance	36	37	29	29	44	37
Guidelines	16	10	22	10	12	13
Guidance	30	49	38	50	24	35
Human error	4	1	3	4	5	4
Resources	5	1	2	2	3	3
Not clear	9	2	6	5	12	7
	100	100	100	100	100	100

NGO/NEX audit opinions

58. Finally, in reviewing the adequacy of the scope of NGO/NEX audits, OAPR identified the audit opinions expressed in each report as qualified, unqualified, adverse or disclaimer (see annex 6 (f) for definitions). Table 5 presents the opinions for the 1,717 reports received.

59. Of the reports, opinions were 50 per cent (853 reports) "unqualified," 35 per cent (607 reports) "qualified", 1 per cent (10 reports) "disclaimer", and six reports "adverse". For another 1 per cent (18 reports), an opinion could not be determined. For the remaining 13 per cent (223 audit reports), the final evaluation letters were in progress, as these reports had not been submitted by the required submission date.

Table 5. Audit opinions in reports for fiscal year 2004: percentages, by region

Opinion	RBA	RBAP	RBAS	RBEC	RBLAC	Total
Unqualified	38	30	50	78	62	51
Qualified	34	62	37	22	27	36
Adverse	1	0	1	0	0	0
Disclaimer	2	0	0	0	1	1
Not provided	2	0	0	0	1	1
In progress	23	8	12	0	8	11
	100	100	100	100	100	100

60. The "qualified" opinions covered observations referring to a direct financial impact, as well as observations pertaining to weaknesses in internal controls which could have financial consequences if not addressed. The observations pertaining to "qualified" opinions related mainly to (a) discrepancies between the CDR and the project financial reports; (b) under-utilization of budget lines; (c) non-completion of project activities; (d) no insurance coverage for project equipment; (e) delays in submitting quarterly and annual progress reports; (f) inconsistencies between the annual work plan and annual report; (g) annual work plan not adequately approved by the parties involved; (h) vacant positions not filled during the year; (i) bank reconciliations not prepared; (j) inadequate record keeping and lack of awareness of NEX guidelines by project authorities;

(k) lack of adequate documentation to support payments; (l) differences identified among various financial reports; (m) inadequate monitoring and evaluation; and (n) an inadequate accounting system. Based on available information, the "qualified" opinion pertained to about $136 million, or 10 per cent of the total audited NGO/NEX project expenditure. A further analysis of the opinions indicated that "qualified" opinions referring to direct financial impact amounted to about $13 million, or 0.9 per cent of the total audited NGO/NEX project expenditure. The balance represented qualifications due to weaknesses in internal controls and procedures that either did not have a direct financial impact or where the auditors did not specify the related financial impact.

61. The "adverse" opinions were rendered as a result of observations related mainly to (a) CDRs not reflecting the real expenses incurred by the project; (b) preparation of quarterly financial reports not in compliance with the project document; (c) CDRs containing expenditures related to prior years; (d) certain significant allowances not in compliance with the project document; (e) significant expenses assigned to incorrect budget lines; (f) no compliance with the procedures established for contracting national consultants; and (g) disbursements equivalent to over 50 per cent of total expenditures without the supporting documentation. Based on available information, the "adverse" opinion had a net financial impact of $10 million.

62. The "disclaimer" opinions were rendered based on observations related mainly to (a) auditors not having access to quarterly and annual financial reports; (b) no bank statements, no files and supporting documents for expenditure incurred; (c) project directors not signing the CDR because the conciliation processes with the regional offices was not concluded; and (d) inadequacy of the bookkeeping systems in place. Based on available information, the "disclaimer" pertained to about $10.5 million, or 0.8 per cent of the total audited NGO/NEX project expenditures.

63. The outcomes of these audits were raised with the management of the concerned country offices, which were requested to take immediate corrective actions. Action plans already submitted by the country offices to OAPR indicate that, in the great majority of cases, actions have been taken or initiated to address the outcome of the NGO/NEX audits.

Role of regional audit service centres in NGO/NEX audits

64. During 2005, in addition to the new evaluation strategy performed at headquarters, OAPR also strengthened the follow-up on NGO/NEX issues contained in the evaluation letters during country office audits by RASCs.

65. During these audit missions, the teams included a brief presentation for the country offices on the requirements for NGO/NEX audits and areas that required improvement. The purpose of these presentations was to raise awareness and accountability of internal control systems for NGO/NEX projects management and of the requirements of NGO/NEX audits. More formal training modules for field-based staff are to be developed.

Implementation status of NGO/NEX audit recommendations – country offices and NGO/NEX projects

66. Of the 122 country offices evaluated in the prior year audit exercise (2003), OAPR received 114 follow-up action plans (equivalent to 93 per cent). Of the 114 country offices evaluated for the current year audit exercise (2004),

75 follow-up action plans have been received to date (equivalent to 66 per cent). OAPR noted a significant improvement over prior years. Significant issues identified in the 2004 project audit reports are presented in annex 7.

67. To assist country offices in following up on the recommendations, OAPR included a consolidated report by project and audit area, and certification by the local auditors. For audits in 2006, these plans are to be followed up and certified by the auditors to obtain adequate assurance that necessary actions have been taken by project management. Furthermore, OAPR revised the structure and contents of the terms of reference for NGO/NEX audits to provide clear, detailed information to country offices towards improving the audit scope and audit report contents. The new audit scope requirements include:

(a) The certification of three audit areas: (i) statement of expenditure (CDR); (ii) cash position reported by the project as at 31 December 2005; and (iii) status of assets and equipment as at 31 December 2005.

(b) Auditors must indicate the risks associated with their findings and provide a categorization by risk severity: high, medium, or low.

(c) Auditors must provide a classification of possible causes of the audit findings.

(d) Country offices must ensure the audit services are adequately covered as specified in the revised TOR for NGO/NEX audits.

VII. Investigation services

68. In 2005, the Investigation Section completed its second full year of operations, and by mid-year it had achieved full staffing. Those resources are now being supplemented with professional investigators hired as consultants on an as-needed basis.

69. The Investigation Section participated in the formulation of the UNDP fraud policy. Work continued on developing a fraud resource toolkit in the form of a CD-ROM. In May 2005, a fraud hotline was set up in OAPR, providing a confidential and easy means of reporting allegations of fraud and abuse through telephone, fax, email, or an Internet web page accessible through the external and internal UNDP websites.

70. In 2005, there was significant increase in the number of allegations received (see table 6). This can be attributed to: (a) the hotline; (b) the heightened awareness of actions being taken against staff determined to have committed fraud and misconduct; (c) the effectiveness of UNDP initiatives in encouraging staff to report misconduct; and (d) the external environment in the United Nations system environment.

Table 6. Comparison of cases between 2004 and 2005

Year	New cases accepted	Cases completed	Cases carried forward
2004	27	18	9
	(plus 3 carried forward from 2003)	3 (from 2003)	-
2005	108 (400% increase)	48 (229% increase)	60 (from 2005)
	(plus 9 carried forward from 2004)	7 (from 2004)	2 (from 2004)

71. The increase in the number of cases resulted in a long list of open cases in 2005, so a strategy was put in place to address this, including hiring consultants in the field and at headquarters to assist in the investigation work.

72. An analysis of these cases indicates a large percentage coming from the hotline (31 and 13 per cent from OAPR and the Office of Internal Oversight Services, respectively). Others were detected and reported by the offices themselves (16 and 14 per cent from country offices and headquarters, respectively), while still others were detected during the internal audit exercise (10 per cent) (see annex 8).

73. The analysis further disclosed that 20 per cent of the cases pertained to procurement irregularities, such as no competitive process, errors in the procurement process, and disputes with suppliers. Another 20 per cent were related to inappropriate conduct of staff, while 19 per cent pertained to personnel matters, such as recruitment, termination, contracts, and abuse of authority (see annex 8). Of the 55 cases completed in 2005, 28 were unsubstantiated and the rest were submitted to OLPS and Office of Human Resources. Those that pertained to United Nations staff were referred to the United Nations Office of Internal Oversight Services (see annex 8).

74. Thirteen investigation reports were submitted to OLPS for review and determination of disciplinary measures or financial recovery. From these, OLPS recommended the summary dismissal of four staff members; issued two letters of reprimand to staff members; and allowed another staff member to resign but made full recovery of funds, as well as in the non-renewal of five service contractors (two for UNOPS, two for UNDP and one for the United Nations Volunteers programme). Where appropriate, the section refers matters to local authorities for investigation.

75. Major cases of fraud investigated in 2005 included:

(a) The confirmed theft of $190,000 occurring in a country office. The two UNDP local staff members believed to be behind the theft had left UNDP before the investigation began, and the matter has been referred to local authorities for further investigation, including determination of any additional theft. Management immediately suspended the operations of the projects where fraud had occurred, and a more extensive audit was fielded to address underlying issues and determine managerial responsibility.

(b) A staff member in the finance section of a country office who stole $135,500 was summarily dismissed, and UNDP initiated financial recovery.

(c) At a headquarters office, a staff member made 761 fraudulent transactions totaling $89,741.15 on a corporate credit card between 2001 and 2005. The staff member was summarily dismissed, and full recovery is in process.

(d) Following a referral from the local authorities, police arrested and detained in custody a suspect alleged to have stolen $152,000 from UNDP by presenting forged checks. The sum of $57,000 had been recovered at the time of writing this report.

VIII. Advisory and management services

76. OAPR provided advisory services to offices at headquarters, regional bureaux, regional centres and country offices, generally by submitting comments on audit-related policies and practices; audit of grants connected with the Global Fund to Fight AIDS, Tuberculosis and Malaria; generic cost-sharing agreements for small contributions; guidelines for the Millennium Trust Fund; headquarters procurement audit policy; procurement audits; and others. OAPR reviewed a substantial number of memoranda of understanding and agreements with donors. OAPR also participated actively as an ex-officio member of the information and communication technology (ICT) board.

77. The quantity and varied nature of advisory services sought from OAPR by all levels of UNDP management shows that OAPR is adding value to the UNDP governance and control processes.

IX. Coordination with external auditors

78. The external auditors, the United Nations Board of Auditors, reviews the internal audit function of UNDP in order, among other purposes, to assess its effectiveness and determine the extent of the reliance on the work of OAPR. In this context, OAPR and the external auditors consult on a continuous basis and coordinate their plans to avoid overlaps and duplication of effort. During the planning stage, OAPR consults with the auditors in preparing the strategy and annual work plan to discuss priorities and strategies that complement audit coverage, and each follows up on the audit recommendations of the other. It is important for OAPR to keep increasing its audit effectiveness so that the external auditors can continue to rely on its work.

X.Coordination with other United Nations oversight offices

79. During the year, OAPR continued to coordinate with other oversight offices of the United Nations system, including the Panel of External Auditors, the Joint Inspection Unit, OIOS, the representatives of United Nations internal audit services, and the Investigations Group of the United Nations system. OAPR participated in the annual meetings of the internal auditors and investigators of United Nations organizations and multilateral financial institutions.

XI. Framework for the future

80. While improvements have been achieved in 2005, OAPR needs to do more to enhance its internal audit and investigation functions. To that end, OAPR

formulated a three-year audit and investigation strategy for 2006 to 2008 and an annual work plan for 2006, to ensure efficient, effective use of UNDP resources. Through its work, OAPR seeks to continuously assist UNDP management and staff in enhancing governance and oversight management; ensuring a robust accountability framework and increasing transparency; championing risk management; and promoting a culture where managers and staff act with integrity while achieving UNDP development objectives.